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Srovnání regulace na finančních trzích v Číně a USA
Comparison of Financial Market Regulation in China and the USA

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1. Introduction
2. Principles of Financial Market Regulation
3. Regulation of Financial Markets in China
4. Regulation of Financial Markets in the USA
5. Comparison of the Selected Markets
6. Conclusion
Bibliography
List of Abbreviations
Declaration of Utilization of Results from the Bachelor Thesis
List of Annexes
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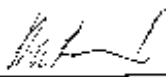
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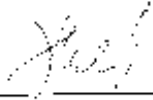
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1 Introduction

Financial regulation is one of the most difficult problems in the world which each country will face. Since the financial crisis in 2008, the research and discussion about financial regulation became more and more gradual owing to severe economic environment. Under these circumstances, China and the USA arise plenty of policies and strength the function of regulators. However, there do still exist some financial regulation problems in these two countries.

The goal of this thesis is to state the financial regulation situation in China and the USA and get the recommendation from the comparison of these two countries.

First of all, this thesis will introduce the basic knowledge of financial market regulation. It includes the definition, purpose, content, principles of financial regulation and describes the two main fundamental methods of financial supervision. What is more, in this section, we will discuss the importance of financial regulation and the problems we should deal with.

In the second part will be introduced the financial market regulation in China. The whole financial regulation development of China can be separated into three periods. Up to now, there are still some problems in financial regulation system that should be solved. Especially after the global financial crisis, the financial regulation in China is facing a serious challenge.

The third part is about the financial regulation in the USA. As an economy leading country in the world, the USA goes through eight period's progress. It forms a supervision system whose shape is like an umbrella after amount of amending. We cannot deny that during period of financial crisis, the government of the USA has done a lot of efforts in order to escape from the financial crisis and decrease the supervision problems. Hence, in this sector, we will pay more attention on present failure example analyzing the basic reasons and the influence of financial regulation reform.

The last section is comparison between China and the USA. As two of important markets in the world, the financial regulation system has something similar and different. We can gain

inspirations through comparing the different items basing on two countries. And what more important is to learn the method of enhancing the present financial regulation problems.

Above all, we are aiming to get recognitions on financial regulation development and by comparing the differences between two countries research the way to improve the financial regulation system in China.

2 Principles of Financial Market Regulation

This part will discuss fundamental conceptions about financial market regulation such as definition of financial regulation, importance, purpose and basic principle, content and method, regulate target, mixed and separated regulation.

2.1 Definition of financial regulation

Financial regulation is a term for the government taking financial supervision and financial management to special institutions.¹ Throughout all countries in the world, each country which put the market economy into practice, objectively existing the regulation of financial system.

From the meaning of the word, financial supervision indicates that monetary authorities inspect and supervise financial institutions entirely and regularly so as to promote a steady business of financial institutions in conformity with legal provisions. Financial management indicates that monetary authorities lead, organize, coordinate and control a series of activities to manage financial institutions and operating activities.

Financial regulation is divided into narrow sense and broad sense. In a narrow sense of the word, it means central bank or other monetary authorities rule that the whole financial industry including financial institution and financial business will be supervised according to the national laws. In a board sense of the word, besides above-mentioned connotations, it also includes internal control and audit of financial institutions, supervision from interbank self-supervision organizations and social intermediary organizations etc.

2.2 Importance of financial regulation

There is widespread existing financial supervision among financial area of each country in the world and financial supervision contains the deep reasons.

¹¹Source:http://baike.baidu.com/link?url=S_c7x4JTq4rcMcmD5vZGqvGILMW6YYYYEOUvGa8ky7v4Jo-9nc6ReSMIHojex3dxs

2.2.1 Financial market failure and defect

Financial market failure means that financial market cannot allocate resource ineffectively.² It mainly aims at the problems that monopoly or oligopoly owing to allocation of financial market, diseconomy scale and externality etc. Financial supervision attempts to correct financial market failures by a kind of effective measure however, in reality, the discussion of it concentrates more on affect of regulation rather than the aspect of necessity.

2.2.2 Moral hazard of financial regulation

Moral hazard means that it occurs some degree of pernicious affect owing to change of financial sector behaviors. Under the market economy market, depositor (individual or collective) must estimate the security of commercial financial institution.

However, in a supervised financial system, individual and collective subject usually consider that government ensure the security of financial institution or pay back deposit when break the contact at least, so they do not think the moral hazard of bank. Generally speaking, financial supervision is used for decreasing the cost of financial market, keeping a equitable financial order, promoting the confidence of the public. Therefore, regulation is a kind of public good, a kind of supervision which can increase the public financial confidence provided by government public sector, which is an efficient and necessary supply of financial market failure.

2.2.3 The development of monetary institution

The changes of modern monetary institution from actual goods, noble metal form to credit form. On the one hand, it increases the efficiency of financial market treatment and resource allocation; on the other hand, it leads to modern paper currency institution and fractional reserve institution, which are two vital innovations of financial institution.

² Source: <http://wenku.baidu.com/view/fd39dba7f524ccbff1218426.html>

2.2.4 Credit creation

The substance of financial institution products and service creation is a kind of credit creation. For one thing, it can save monetary, decrease opportunity cost, for another thing, commercial structure will face more complex payment risk. Financial system is one of most typical economy system of domino affect. It will cause chain reaction that the suspect of any financial institution cannot achieve, the run suddenly occurs will let the financial institution sink into payment risk in a short period. It also leads to the public loose the confidence of finance and the whole financial system collapse finally. The globalization of finance will react rapidly to world financial market.

2.3 Purpose of financial regulation

The purposes of financial regulations mainly contain six aspects and there is what we speak about.³

- Keeping healthy economy order

To preserve financial industry operate in a healthy order, minimize the risk of bank industry, guarantee the interests of depositors and investors, promote a healthy development of bank industry and economy;

- Keeping suitable capital loans

To ensure the needs of fairly and efficiently issuing loan, get rid of out-of-order transferring capital; prevent the fake activities or improper risk transfer therefore;

- Separating the loans to different industry

Financial regulation avoids the excessive centralization of currency distribution in a manner;

- Raising the social welfare

- Not only does it take tremendous expense when banks go bankrupt but also spreads to other areas of national economy. Financial regulation can insure financial services to achieve a determined level so as to arise the social welfare;

³Sources:http://baike.baidu.com/link?url=S_c7x4JTq4rcMcmD5vZGqvGILMW6YYYYEOUvGa8ky7v4Jo-9nc6ReSMIHojex3dxs

- Ensuring the working mechanism

Central bank transmits monetary policies to other national economy areas by reserve currency and assets allocation;

- Delivering the default information

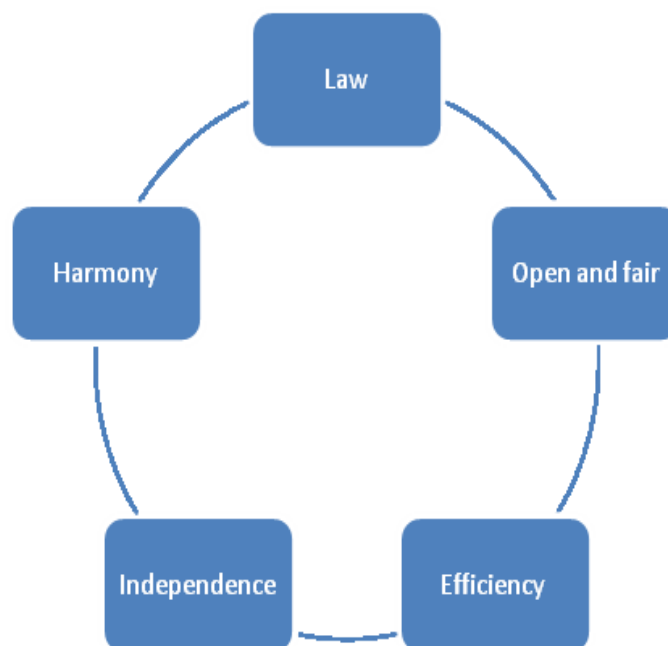
Financial regulation can provide trade account and transmit the information about default risk.

2.4 Basic principles of financial regulation

Principles of financial regulation by law are by that during the government financial supervisor institution and financial institution internal regulation activities; it ought to adhere to the pursuit of value and lowest behavior standard.⁴

Financial regulation should persist in following basic principles which are very important.

Figure 2.1 Basic Principles of Financial Regulation



Source: Baike Baidu, author

⁴Sources:http://baike.baidu.com/link?url=S_c7x4JTq4rcMcmD5vZGqvGILMW6YYYYEOUvGa8ky7v4Jo-9nc6ReSMIHojex3dxs

2.4.1 Principles of law

The principle by law is also known as legality doctrine, it means that financial regulation must implement according to laws and regulations. The main body of regulation, the duty and authority of regulation, supervision measures are all stipulated financial supervision statutes and related administration laws. All supervision activities suppose to be in progress in conformity with legal provisions.

2.4.2 Principles of open and fair

Supervision activities should enhance the pellucidity into full maximize. At the same time, supervision authorities ought to be justicial and equally treat to all of participators in financial market, and actualize the fair of main body and procedure.

2.4.3 Principles of efficiency

It means financial supervision should arise the whole efficiency of financial systems and cannot inhibit financial creation and financial competition. Meanwhile, financial supervision authority should legitimately allocate and get fully use of supervision resource so as to cut down costs, reduce social expenditure retrenching the social public resource.

2.4.4 Principles of independence

Bank industry supervision and management institutions and the staff who work for them should perform the duty of supervision by law.

2.4.5 Principles of harmony

Among the main body should supervision clear responsibility, divide rationally, coordinate with each others. In this way, can they economize the costs of supervision and advance regulation efficiency.

2.5 Content of financial regulation

The content of financial supervision include the establish of financial institution, financial institution assets and liabilities of business, losing the account, foreign exchange and foreign loans, financial market such as market access, market finance, market rates, market rules and so on. Besides that, it contains the supervision of gold, the security industry, the insurance industry, the trust industry, the financial leasing.

Among these, what is the most essential point is regulation of bank industry. The main content includes market access and institution merger annexation, range of bank business, risk control, liquidity management, capital adequacy ration, deposit protection and risk dispose etc.

2.5.1 Proclamation supervision

Proclamation supervision means that government does not supervise the business of financial industry directly rather rules that financial enterprise must submit the operation results according to formulary format and content results to government agency-in-charge and make announcement. As to financial institution form of organization, standard of financial enterprise and utilization of financial capital are completely self-administrated by financial enterprise, government do not intervene it to some extent.

The content of proclamation supervision includes announce the financial statements, lowest capital and margin stipulate, solvency ability standard regulation. Under the proclamation supervision, the conditions of financial enterprise business count on themselves and common people. This kind of style combining government with people is beneficial for financial institutions which can develop in a more loose circumstance with freedom.⁵

However, owing to information asymmetry, it is difficult for financial enterprise and people to judge the situation of financial enterprise operation and incapable of action in

⁵Source:<http://www.kpmg.com/cn/en/issuesandinsights/articlespublications/newsletters/china-financial-regulation-alert/pages/default.aspx>

improper business. So proclamation supervision is one of most loose supervision methods in financial supervision.

2.5.2 Standard supervision

Standard supervision is called criterion supervision as well; it means country sets serious standards to rule the operation of financial industry. Under this standard supervision, government definitely rules amount important items about financial enterprise operation such as lowest capital of financial enterprise, audit of financial statements, utilization of capital, punishment of breaking the law and so on. Nevertheless, government do not intervene the business operation of financial enterprise, financial management and personnel.

This kind of supervision method emphasizes the legality of operation form, which is more manipulative comparing with proclamation supervision. However, it is hard to come into strict and efficient affect only by some fundamental regulations instead of connecting entity of financial enterprise operation.

2.5.3 Entity supervision

Entity supervision means that country set up perfect management rules of financial supervision. Financial supervision institution efficiently regulates and manages financial market, especially financial enterprises.

In addition, the process of entity supervision is separate to periods:

- The first stage is to supervise at the time when setting up financial industry, which known as the supervision of regulatory commission;
- The second stage is to supervise during the operation of financial industry, it is the core of entity supervision;
- The third stage is supervision of the financial enterprise bankrupt and clearing;
- The entity supervision reflects that country powerfully regulates financial enterprise by administration method basing on legislation which is more strict, specific and effective than proclamation supervision and standard supervision.

2.6 Target of financial regulation

The traditional target of financial regulation is domestic bank industry and nonbank financial institution. However, as the constantly creation of financial instrument, the target of financial supervision gradually expand to the financial institution whose nature of business is similar to bank such as collective investment institution, loan societies, affiliated company of bank or share holding companies of bank which launches exact bank business, even including the drawer and broker who is relative to the business of gilt-edged bond market etc.⁶

Nowadays, the whole financial system of entire country is regarded as target of financial supervision as well.

2.7 Mixed regulation

Financial mixed regulation means that only one supervision institution entirely proceed in regulating overall financial institution business.

From the point of the practice of international financial mixed regulation, there are two main representative patterns named *integrated supervision*. It means one in which a single universal regulator conducts both safety and soundness oversight and conduct-of-business regulation for all sectors of financial services business. And *functional supervision* which means in which supervisory oversight is determined by the business that is being transacted by the entity, without regard to its legal status. Each type of business may have its own functional regulator in the USA.⁷

Both integrated supervision and functional supervision have superiority and defect and it is the reason that why the other side exists.

⁶Source:http://baike.baidu.com/link?url=S_c7x4JTq4rcMcmD5vZGqvGILMW6YYYEOUvGa8ky7v4Jo-9nc6ReSMIHojex3dxs

⁷ Source: The Group of Thirty, *The structure of Financial Supervision Approaches and Challenges in a Global Marketplace*, 2008, page 83, ISBN 1-56708-142-8

2.7.1 The main reasons supporting single direction supervision

Integrated supervision more focus on some single departments owing to the development of financial group and the gathering of financial business gradually instead of estimating the payback ability of financial group. Under this situation, if taking functional supervision, it leads to break the obligation of supervision and cannot correctly estimate the entire security of group stable situation.

Because of the prosperous development of financial innovation, the update financial goods are instantly created which cannot be strictly classified into a functional type so that it brings uncertainty to supervision.

Under the functional supervision, the financial institutions providing similar financial services are supervised by different supervision institutions owing to belong to the different types of function and it is limited by various supervision standards and rules which is opposite to the principle of fair. Even worse, it will lead the financial institution change their classification and occur the phenomenon named regulatory arbitrage.

The integrated supervision can integrate the supervision resource, forming the scale affect and decreasing the supervision cost.

2.7.2 The main reasons supporting functional supervision

Some fixed differences in different financial sectors possibly will cause integrated supervision institution do not have exact supervision goals, even appearing goals which are conflict to each other. There are two disadvantaged results owing to indistinct supervision goals: lacking of consistent behavior standard and losing the efficiency.

Integrated supervision lead to spread of scared through different financial departments. When anyone of financial sectors arise failures, the public will loose the confidence of financial institution.

In integrated supervision, supervisors are easy to arise group-think and focus on the most risk business or sectors and ignore other sectors and business.

Integrated supervision is still set up in traditional function, which cannot ensure the scale affect and increase the efficiency.

2.8 Separated regulation

Separated regulation means that basing on financial system fundamental function to design more consistent supervision.⁸

In this frame of financial supervision government public policy concentrates on business activities of financial institution and function instead of the name of financial institution. The aim of separated regulation is to in the given situation and finds the most effective institution structure.

2.8.1 The advantage of separated supervision

- Separated financial supervision system is more adapt to the requisition of supervision system. It can effectively solve the ownership of financial innovation goods;
- Separated financial supervision system is more effectively against the financial risk. With more and more inter industry financial goods appearance, separated supervision publish unite institution to regulate the entire supervision;
- Separated financial supervision system is more useful to carry on financial innovation. Because this kind of supervision can solve regulatory problems, so managers can fix on achieving effective regulation.

2.9 The problem of regulation in financial market

After sub-prime crisis, most economists believe that the reason of the USA financial crisis is failure of government supervision. Improper regulation structure can lead to financial expert industry (losing fair), economist corporation (losing independence), government supervision mend the fold after the sheep have been stolen (losing warning), it is the control chain to form the systemic global financial crisis.⁹

⁸Source:<http://www.kpmg.com/cn/en/issuesandinsights/articlespublications/newsletters/china-financial-regulation-alert/pages/default.aspx>

⁹ Source: <http://xuewen.cnki.net/CJFD-ZZJJ201116071.html>

Besides, the legislation system of financial supervision has not been completed yet. Among these legislations, there exists quantities of principled rules, which lacks of operability in reality and sometimes it conflicts to each other. These all influence the efficiency of regulation and achievement of justice.¹⁰

What's more, the regulation level of internet financial business lags a lot with times comes into 1980s. The fast development of IT and internet promotes a deep degree increasing of global economy. However, the relevant supervision is old that cannot be suitable for the new challenge. Therefore, we should pay attention on the countries with different kinds of financial regulation and compare together to conclude the information about setting financial regulation typically.¹¹

¹⁰ Source: http://www.china.com.cn/economic/txt/2009-05/25/content_17832499.htm

¹¹ Source: <http://news.163.com/10/1123/10/6M5TDOD900012Q9L.html>

3 Regulation of Financial Markets in China

Under the fierce international economy environment, the financial regulation system is more and more important for government to choose and Chinese government in order to suit the trends of financial development has changed the financial market regulation from laws and system.

3.1 History and development trends

There existing three periods in the development of financial regulation in China. It is generally from the centralized and unified supervision to separated supervision. And it will go to mixed supervision in the future.

3.1.1 Initial reforming (1980-1991)

From the beginning of reforming and opening to the medium of 1980s, the market of China security had not been formed yet, the only insurance company is *PICC(People's Insurance Company of China Holdings Company)* which is also a subsidiary institution of *PBOC(People's Bank of China)*. Four major specialized banks and PICC have a distinct division and the crossover business is not allowed definitely. On September 17th in 1983, the State Council establish a decision about let PBOC own specialization function from central bank. The decision point out that PBOC is a government agency leaded and managed national financial enterprise by the State Council and take management measures on specialized banks and other financial institutions (including insurance company) from the aspect of economy. What's more, each specialized banks and other financial institutions must implement decision made by PBOC or PBOC Council, otherwise PBOC have the right to punish on economy and administration.¹² With the gradually establishment of various nonbank financial institutions oriented by security institutions, plenty financial business show up a seriously mixed operation. From the year of 1984, China formed a binary bank system of central bank and

¹² Source: <http://www.docin.com/p-90776949.html>

specialized banks which mean PBOC perform the function of central bank and at the meanwhile fulfill the synthetical supervision to bank industry, security industry, insurance industry and trust industry.

On January 17th in 1986, the State Council establishes a temporary ordinance *Interim Regulations of the Peoples Republic of China on the Management of Banks* which is the first administrative law of systematically regulating financial supervision. It establishes the law position of PBOC by the form of administrative legislation for the first time, which means that PBOC is a government agency leaded and managed national financial enterprise by the State Council, is the national central bank. In addition, the financial supervision function of PBOC based on the target of financial supervision contains all the types of financial institution at that time, including specialized bank, insurance company, trust investment company, rural credit association, urban credit cooperative and other financial organizations set up by PBOC. The financial supervision system established by law performs a unified and compensative supervision system leaded by central bank.

3.1.2 Separated supervision period (1992-1997)

After 1992, the Chinese financial institutions increase, the security market expands fast, the trust industry develops ups and downs, the competition between bank industry and insurance industry is more and more fierce, especially the situation of partial macroeconomics finance uncontrollable and messy finance order arise, the importance of financial regulation gradually become prominent, the financial supervision system step into a new stage from mixed regulation to separated regulation transition. In August 1992, the State Council determines to publish the *Securities Commission and China Securities Regulatory Commission (CSRC)*, which separates the supervision function of security from PBOC. PBOC majors in regulating the banks, insurance and trust industry. In order to strengthen the macroeconomic control, in July 1993, China begins to measure 16 control plans oriented by consolidate the financial order. At same year, the State Council establishes a decision about the reform of financial system, which ensures the PBOC a real central bank and achieves the change from national specialized bank to commercial bank. In 1994, the State Council arises

the request that bank industry, insurance industry, security industry and trust industry should perform the separated business. During this period, PBOC takes charge of not only regulating of bank industry and insurance industry but also approving the security business organization. China Securities Regulatory Commission takes charge of supervising the business operation and security market of security institution, the financial supervision system performs from centralized and single regulation to separate regulation.

In 1995, the Third Session of the Standing Committee of the Eighth National People's Congress passed *The Law of the People's Republic of China on the People's Bank of China* which definite two duties of PBOC as a fundamental laws of nation including setting up monetary policy and financial supervision which ensures the regulation to bank, insurance and trust industry by PBOC.¹³

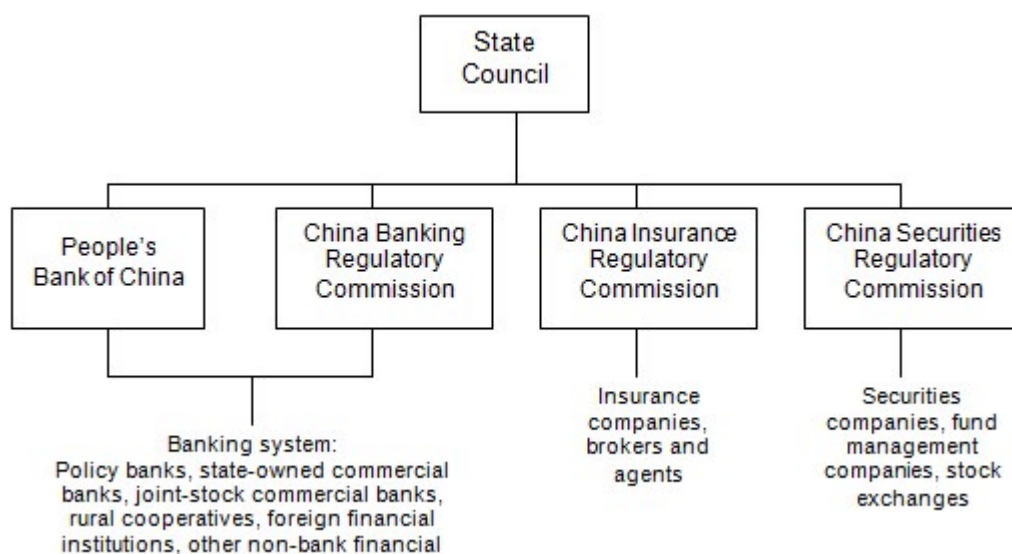
3.1.3 Finally forming (1998-now)

Securities Law of the People's Republic of China is established in 1998 which confirms the State Council security supervision and management institutions can regulate national security market comprehensively as the form of law. At the meanwhile, the State Council and each supervision institution set up and publish plenty administrative regulations and management rules based on legislation, which is positive for carrying out the financial supervision laws. In November 1998, the establishment of *China Insurance Regulatory Commission (CIRC)*, especially charges the supervision of insurance industry and PBOC does not perform the regulation duty of insurance. Since then, PBOC removes the supervision rights of security industry and insurance industry to China Securities Regulatory Commission and China Insurance Regulatory Commission. China formally raises the financial separate regulation system supervised bank, security and insurance business by PBOC, China Securities Regulatory Commission and China Insurance Regulatory Commission. In October 2002, the fixed *Insurance Law of the People's Republic of China (2002 Amendment)* ensures the law position of insurance institution supervise and manage the insurance industry.

¹³ Source: <http://www.docin.com/p-90776949.html>

In April 2003, the First Session of the Tenth National People's Congress publish the setting of *China Banking Regulatory Commission (CBRC)*, which perform the responsibility of banking industry supervision and regulate bank, financial capital management company, trust investment company and other deposit financial institutions according to law, forming the system of CBRC, CSRC and CIRC. Financial supervision authorities entirely get apart from central bank who makes the monetary policy, setting up a system of independent, complete financial separate regulation. In October 2003, The Standing Committee of the National People's Congress revise *The Law of the People's Republic of China on the People's Bank of China* and *Law of the People's Republic of China on Commercial Banks (2003 Amendment)* which means the duty of PBOC has changed, the legal status of central bank gets purified and protruded. The function of PBOC focuses on monetary policy and macroscopical venture control which can reflect the change of financial supervision system. On February 1st, *Banking Supervision Law of the People's Republic of China* regulates the banking supervision institutions, regulates target, principle, supervision responsibilities and measures, improve supervision system, and strengthen supervision method. The following is the financial supervision system regulatory structure in China.

Figure 3.1 Financial Supervision System Regulatory Structure in China



Source: <http://www.lboro.ac.uk/gawc/rb/rb314.html>

3.1.4 Mixed supervision trends

In August 1999, PBOC publishes the rules of security company and fund company which decide that PBOC supervise the security company and fund management company under the model of mixed operation. In July 2001, PBOC publishes a determination about supervising non-bank financial business. And in August 2004, CSRC and PBOC set up a regulation that the trade and clearing activity of monetary market fund in national banks should comply the rules and observe the dynamic check and regulate of PBOC. Nowadays, the supervision system which suits the mixed operation is a bit of general, and it belongs to PBOC to perform the regulation as a whole.

It can be explicitly observed that China financial regulation system comply the rule that performs financial supervision system firstly then sets up the fixed law and rules to permit or allow it which means the construction of legislation falls behind the financial supervision system practice.

Figure 3.2 Main Legislation on Financial Supervision in China

Company Law of the People's Republic of China

- **Date issued:** 12-29-1993
- **Issuing authority:** National People's Congress

Law of the People's Republic of China on the People's Bank of China

- **Date issued:** 03-18-1995
- **Issuing authority:** National People's Congress

Law of the People's Republic of China on Commercial Banks

- **Date issued:** 05-10-1995
- **Issuing authority:** Standing Committee of the National People's Congress

Insurance Law of the People's Republic of China

- **Date issued:** 06-30-1995
- **Issuing authority:** Standing Committee of the National People's Congress

Securities Law of the People's Republic of China

- **Date issued:** 12-29-1998
- **Issuing authority:** Standing Committee of the National People's Congress

Banking Supervision Law of the People's Republic of China

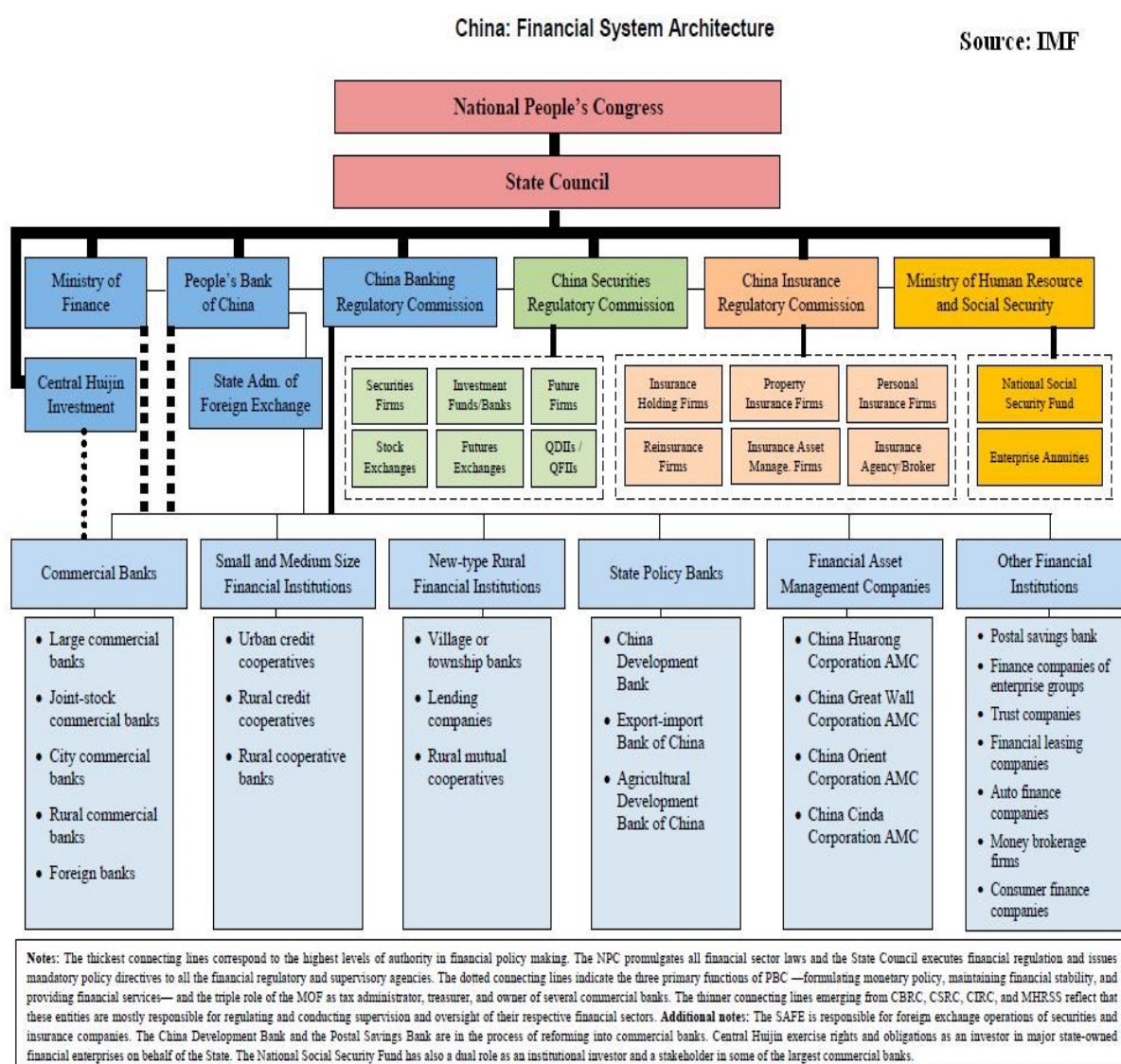
- **Date issued:** 12-27-2003
- **Issuing authority:** Standing Committee of the National People's Congress

Source: <http://www.lawinfochina.com/index.aspx>

3.2 Present supervision situation and existing problems

There still existing some problems in the financial supervision system in China. And the conflict between multiple regulations and cross regulation will lead to the low supervision efficiency. Some blind area of supervision also existing in the financial holding company which increases the difficulty of regulation. In addition, the financial innovation supervision gradually becomes important part of financial supervision.

Figure 3.3 Financial System Architecture



Source: <http://www.creditwritedowns.com/2011/12/chinas-financial-architecture.html>

3.2.1 Conflict of multiple and cross regulation

- Multiple institutions can easily lead to supervision conflict.¹⁴

Nowadays, China separates the duty of supervising bank, on-bank financial institution, security company and insurance company to CBRC, CSRC and CIRC. However, the appearance of financial holding company challenges the model of separated regulation.

Owing to different targets of regulatory institution, the index systems and operation methods are different. So the results of supervision perhaps have a great difference in each regulatory institution. When financial holding company is supervised by one institution, the single supervisor maybe not afford the other supervisors' tasks and responsibilities; especially some bank, insurance, securities and trust companies who belongs to financial holding companies supervised by different regulatory institution.

- The coordination among regulatory departments is difficult and low-efficient.

From the point of the major respects of financial regulations, CBRC, CSRC, CIRC and their assigned institutions is at the same rank. For example, a financial institution operates different business not only bank business but also insurance business and security business, if someone business runs risk, it is hard to ensure that which supervision institution should lead to regulate and which supervision institution should make final decision.

3.2.2 The blind area in regulation

With the development of Chinese finance in mixed operation, financial holding company will become the main form in Chinese financial organizations. Chinese financial holding company has already risen up and got development to some degree.

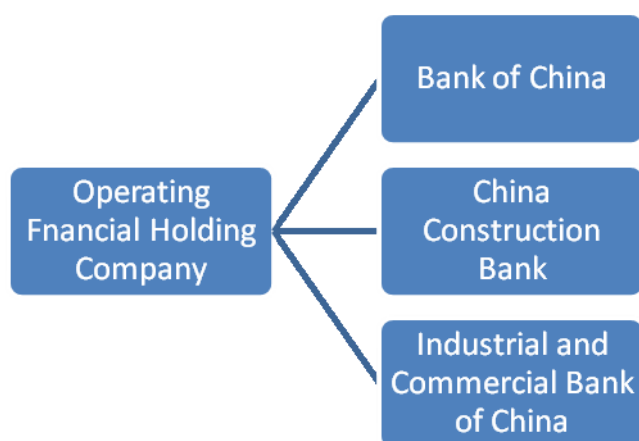
- The model of Chinese financial holding companies which are divided into two types.

The first is operating financial holding company. If the holding company of a group is a commercial bank (also called bank holding company), which possesses some capital or shares of subsidiary companies and institutions including bank, security, insurance, financial service company and nonfinancial equity. The characteristic of this type of financial holding company

¹⁴ Source: <http://wenku.baidu.com/view/fd39dba7f524ccbff1218426.html>

is that controlling company (parent company) itself takes bank business and at the same time the subsidiary company takes relevant business which including bank, security, insurance, trust and other financial. What's more, it should take possible civil liability. The group board of directors has rights to decide or influence the decision of appointing the highest level of managers and vital determination in its subsidiary company. Nowadays, the bank holding companies by this type in China are Bank of China, China Construction Bank, Industrial and Commercial Bank of China etc.

Figure 3.4 Operating Financial Holding Companies in China



Source: <http://wenku.baidu.com/view/fd39dba7f524ccbff1218426.html>

Bank of China¹⁵: Bank of China was formally established in February 1912 following the approval of Dr. Sun Yat-sen. The Bank was listed on the Hong Kong Stock Exchange and Shanghai Stock Exchange in June and July 2006 respectively, becoming the first Chinese commercial bank to launch an A-Share and H-Share initial public offering and achieve a dual listing in both markets.

China Construction Bank¹⁶: China Construction Bank Corporation was formed as a joint-stock commercial bank in September 2004 as a result of a separation procedure

¹⁵ Source: <http://www.boc.cn/>

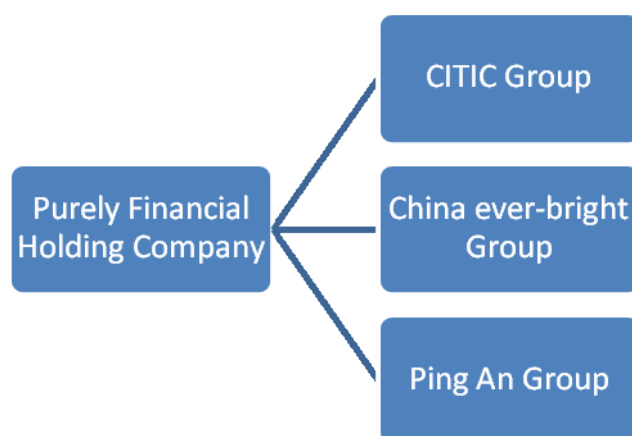
¹⁶ Source: <http://www.ccb.com/en/newinvestor/history.html>

undertaken by our predecessor, China Construction Bank, under the PRC Company Law. Following the China Banking Regulatory Committee's approval on September 14, 2004

Industrial and Commercial Bank of China¹⁷: is the largest bank in the world by total assets and market capitalization. It is one of China's 'Big Four' state-owned commercial banks (the other three being the Bank of China, Agricultural Bank of China, and China Construction Bank).

Another type of financial holding companies is purely financial holding company. It means that the holding company of a group is nonbank financial institution, which owns or has shares on subsidiary company including bank, security, insurance, financial service company and nonfinancial equity. The characteristic of this kind of financial holding company is that controlling company (parent company) itself do not take financial business but the subsidiary company takes relevant business which including bank, security, insurance, trust and other financial business. Parent company controls subsidiary company and sub-subsidiary company by holding shares. The director of group has rights to decide or influence the decision of appointing the highest level of managers and vital determination in its subsidiary company. Nowadays in China, this kind of financial holding companies are CITIC Group, China Ever-bright Group, Ping An etc.

Figure 3.5 Purely Financial Holding Companies in China



Source: <http://wenku.baidu.com/view/fd39dba7f524ccbff1218426.html>

¹⁷ Source: <http://www.icbc.com.cn/ICBC/sy/>

CITIC Group¹⁸: it was founded in Dec 2011, established by CITIC Group Corporation basing on most of operating assets with joint initiation of Beijing CITIC Enterprise Management, one of the Group's wholly owned subsidiaries.

China Ever-bright International Limited¹⁹: China Ever-bright International Group is a fast growing business conglomerate which has integrated project investment, construction engineering, operation management, technology development and equipment manufacturing focusing on environmental protection and alternative energy businesses.

Ping An Group²⁰: Ping An Insurance (Group) Company of China, was established in 1988 in Shenzhen. Today, it has developed into an international financial services conglomerate with three core businesses: insurance, banking and investment.

It strictly carries out separated regulation system in China, which is difficult to efficiently supervise the financial holding company and financial business.

The crossing holding shares in subsidiary company of financial holding company leads complex cooperation structure. The large scale of group and crossing board operation lead internal management completed. The group business relates to various financial businesses which makes operation complex. In this situation, on the one hand, it increases the information asymmetric, which causes difficulty to financial holding companies on external supervision. What's more, owing to it relates to supervision authorities of many industries, each supervision authorities have different supervision targets, methods and main points. Financial holding companies can take measures to evade the regulation and build the lowest cost institution to increase the difficulty in supervising. At the same time, even if each supervision major can efficiently control the supervision targets, the information asymmetric among each supervision majors is hard to control as well, which is easy rising the supervision empty space.

¹⁸ Source: <http://www.citic.com/wps/portal/enlimited/>

¹⁹ Source: <http://www.ebchinaintl.com/en/company/company.php>

²⁰ Source: <http://ir.pingan.com/en/index.shtml>

3.2.3 The financial innovation regulation problems

The financial innovation from 1960s attracts a revolution in financial industry. However, the financial innovation happens together with loosening financial regulation; owing to the fast development of financial innovation, the suitable risk management and risk supervision are not able to follow which causes the drawback of regulation.

China needs financial innovation and develops the market of financial derivative instruments. The financial regulation system now in China is hard to take efficiently supervision.

The reasons why financial instruments are hard to regulate include three points.

- Financial instrument innovation is always developing from nothing and it is hard to forecast in advance under this current supervision laws and system;
- The pros and cons of new financial instruments are always performing after a period of time which makes the financial regulation happen only after event;
- The risk management of financial instrument innovation does not belong to direct regulation area by supervision authorities, which more belongs to financial institution itself.

For all these problems, financial instruments innovation not only becomes the best method to enlarge financial leverage rate of financial institution, but also becomes a problem of financial regulation.

3.3 The impact of financial crisis on regulation in China

At present, the influence on financial system in China is not large. On the one hand, the financial innovation ability of financial institutions is relative weak, and the degree of globalization is low, which is not so deeply participating in the competition of international financial markets so as to escape from a disaster. On the other hand, the POBC pay lots of attention on the financial regulation and make a success to some extent.

However, we should realize the fact that with the faster financial globalization progress, with development of Chinese economy finance and deeper economy integration of the world, the problem exposing is more and more obvious in financial regulation.

It is of some unsure factors that the future development of financial globalization and financial supervision innovation, and we do not know the correct direction in the future as well. Nevertheless, as long as respecting the rules of finance development, forming the aspect of financial regulation leaded by financial innovation, flowing the rules of financial innovation development, improving the various policies. By these methods can we efficiently promote the healthy development of investment system and financing system, can we ensure the lowest influence on this financial crisis so as to develop in a more stable and faster pace.²¹

3.4 The importance of financial regulation reform in China

With the development of financial mixed operation, financial innovation and multiple financial market including financial derivative market forming and developing, financial holding company becomes main and vital model of financial institution, the strictly separated regulation hardly meets the needs and must reform the current financial regulation system.

After China participates into WTO, foreign financial institutions come to China, most of whom are mixed operation and the superiority is obvious. If managing mixed operation which belongs to foreign institutions and cross agency by current separated regulation system will face many new contradicts and difficulties. With the globalization of economy and finance, financial holding company more and more develop cross area or board institution, whereas the accounting standards are different in different countries, areas or financial institutions. Even in the same country or area, owing to difference in operating business of financial holding company, the accounting standards are not the same as well. It influences the stead operation of financial holding company and controlling company accounting information including reality, accuracy and integrity which brings out some trouble to the supervision authorities.²²

²¹ Source: http://blog.sina.com.cn/s/blog_e780a64a01011pi2.html

²² Source: <http://wenku.baidu.com/view/fd39dba7f524ccbff1218426.html>

In a word, the strictly separated management cannot meet the need of financial development and finance internationalization in China and it must start a deep reform and change financial regulation system.

3.5 Example analysis of banking sector

In this part, I will introduce a failure example of Hainan Development Bank.

3.5.1 General introduction

Hainan Development Bank, a joint stock bank in Haikou province in China. Hainan Development Bank is the first one to be closed owing to terrible operation in Chinese Mainland after the found of the People's Republic of China.

The Hainan Development Bank is set up on August 1995, charged by Hainan province government, which includes NORINCO²³(China North Industries Corporation is a leader of Chinese military trade, an important team to implement China's Going Global strategy. The aim of it is to build a world-class multinational enterprise, NORINCO develops a worldwide operation network through responsible operation and sustainable development), China Ocean²⁴(one of the major multinational enterprises in the world, is China's largest and the world's leading Group specializing in global shipping, modern logistics and ship building and repairing, ranking the 327th in Fortune Global 500), Beijing Capital International Airport (BCIA)²⁵ (the largest and busiest international airport in China with the most important geographic location and complete facilities) and other shareholders.

3.5.2 Backgrounds

Before Hainan Development Bank merges the Credit Association, Hainan province is set as a special economic zone. Fast development of economy and real estate industry begins

²³ Source: <http://www.norinco.com/GB/61/64/65/index.html>

²⁴ Source: <http://en.cosco.com/col/col771/index.html>

²⁵ Source: <http://en.bcia.com.cn/news/brigade.shtml>

expanding largely together with many financial institutions. However, these business activities do not efficiently get supervised from government, and real estate industry arises bubble. With the bubble broken of real estate industry, each Credit Association adopts high interest to approve deposit which is easy to strengthen the trouble of Credit Association.²⁶

In October 1997, People's Bank of China announces that five bankrupt Credit Associations in Hainan province are closed which leads Hainan Development Bank to the end.

3.5.3 The close of Hainan Development Bank

After merging Credit Association, Hainan Development Bank declares to pay back capitals and legal interest to primary depositors, so some long-term depositors withdraw capitals and deposit to other banks, which means they do not believe Hainan Development Bank anymore. The run on Hainan Development Bank makes other business hardly operated regularly. At the same time, the broke bubble of real estate industry leads some loans disappear.

In June 1998, the People's Bank of China decides to close Hainan Development Bank and stop any business activities.

3.5.4 The impact of closing Hainan Development Bank

The closing of Hainan Development Bank breaks the financial images of Hainan. And after that, the finance of Hainan is stead weaken.

From the example of Hainan Development Bank, we can conclude that the bad capitals and legislation are not fit to present situation. Some relative institutions do not use the bank regulation laws to supervise the operation of banks so that leads to the bankrupt.

What is more, we can find that we should build the system of financial institution quitting. Hainan Development Bank, as the first bank to be closed, cannot finish the audit and protect the interest of creditors.

²⁶ Source: <http://finance.sina.com.cn/money/bank/20130626/072415917875.shtml>

4 Regulation of Financial Markets in the USA

The USA owns the most developing finance industry in the world; the financial regulation is strict and not lacking flexibility which makes a great contribution to the steady of American economy and development, even to the world economy. The form of financial regulation system in the USA has special history backgrounds, politics, and economy and culture reasons.

4.1 History and development trends

The USA as an immigrant country which keeps ingrained populism ideas, chasing for freedom, equality and fair competition, who is extremely afraid of the concentration of political rights and the attention private economic power. Therefore, this idea runs through the whole American modern process and reforms of the USA monetary band system. Before 1930s, the USA financial industry was less supervised, even after building the *Federal Reserve* in 1913, the state government seldom straightly supervised the financial business as well.²⁷

4.1.1 Primary development (1816-1836)

The *First Bank of the United State* is an embryonic form of the USA central bank which is also the earliest financial management institution. It urges the state banks to return their liabilities so as to keep enough cash reserve and ensure the bank bonds.

The practice of the First Bank of the United State is successful. It suits the need of business, controls the sum of currency surplus and improves the fiscal situation and public credit. The First Bank of the United State creates the history of state government who supervises the bank industry, promotes the combination of the USA monetary system.

In the war from 1812 to 1816, the bank bonds are sharply devaluated, the government has to set up the *Second Bank of the United State*. It successfully performs the duty of

²⁷ Source: Zang huiping, *The Historical Evaluation of U.S Financial Regulatory System*, 2007, page 49

government fiscal agent, meets the need of the Ministry of Finance and promotes the trade activities to avoid the disaster of monetary market.

What is more, the Second Bank of the United State improves the management of state bank bonds limiting the release of bank bonds and it is of good independent from government. However, owing to lacking of elasticity currency, the Second Bank of the United State cannot act the role of final borrower and it is completely against by government, state banks, farmers and entrepreneurs. So the Second Bank of the United State gives up the supervision and management of bank industry.

4.1.2 The free banking period (1836-1863)

After the shutdown of the Second Bank of the United State, the whole bank industry loses the unified adjustment and management institution, the USA bank system suffers from muddle period for 27 years, which calls the free bank period in history. But during the American Civil War, many state banks do not have enough capital and the issuing quality is worse. Therefore, they set up many *Rockoffs* (*Rockoff*, which is also wrote *Wildcat Banking*²⁸) where the transporting address is not convenient and the information is not well-informed. Since then, people recognize the importance of unifying the financial management, which is necessary to the business economy and credit economy society.

4.1.3 Double-track banking system (1864-1913)

At the year of 1864, the government establishes a bill *National Banking Acts of 1863 and 1864* which means the federal government completely and stably intervene financial system area and the establishment of a new franchising bank system. At the same time, it leads double-track into American financial system. This type of structure makes financial regulation of the USA in the characteristics of federal and state.

²⁸ Source: <http://www.docin.com/p-222874142.html>

4.1.4 The establishment of Federal Reserve System (1914-1930s)

After serious financial crisis, people start to consider the problems existing in the USA banks from various perspectives. It lacks a powerful *the last debtors*, an elastic concentrated monetary surplus system and a clear system to link national bank clear business. Therefore, in the year of 1914, the USA government sets up *the USA central bank Federal Reserve System* by law so as to ensure the reserve system, adjust monetary surplus and supervise the national bills and banks.

The establishment of Federal Reserve System is of great significance, it is not only the outcome of game between the Government of the United States of America and local governments for many times but also is the establishment of the financial regulation system of the USA.

4.1.5 Advanced security period (1930s-1970s)

The economy crisis in 1930s announces that the bankrupt of the economic liberalism. It leads the *Keynesian economics* become popular with the western world and occupies the main position in the mainstream economics. Western country governments begin to intervene the economy from each perspectives and the financial industry is the first one to be supervised. The USA as one of the most affected countries, in order to survive from economic crisis, adopts the *New Deal* and supervises the financial industry widely and deeply. The core part of supervision is controlling the currency which issues to the micro behaviors from financial institutions.

The USA announces the *Glass-Steagall Act*²⁹ in 1933 and it ensures the separated operation of banking industry and security industry in finance industry.

One of financial regulation causing by economy crisis is legislation regulation. It includes legislation of bank industry, establishment of the deposit insurance system, legislation of security industry and the legislation regulation of estate finance.

²⁹ Source:http://baike.baidu.com/link?url=GfT9Pe-LRqEcdbghwe1QYOIlmjCevulZdKvunCi4nfAucGJfoV_qngRvCj5DaO3n

Some protocols are forming from the economic crisis and financial crisis, which substantially reforms the financial regulation system from different respects of the USA. And it creates a lot new financial regulation institutions, creating the important turning point in the history of financial management of the USA. From 1940s to the end of 1970s, the USA government issues a series of laws to consolidate and improve the supervision principle and method.

4.1.6 Advanced sufficiency supervision period (1970-1980)

In 1970s, the USA arise the *stagflation crisis*, the *New Economic Liberalism* rally and starts to influence the economic policy. In the sphere of finance, financial institutions are all proceeding financial innovation so as to avoid the government regulation.

The aim of financial reform of the USA in 1980s is expanding the financial business area of deposit institutions and building efficient financial regime, carrying out the interest marketization so as to provoke the deposit and accelerate the development of economy, preventing the *disintermediation* to stabilize the financial system, strengthening the ability of controlling the currency and keeping the stable price level.

4.1.7 Supervision period with security and sufficiency (1990s-2007)

The tides of releasing regulation come to the high tide in 1980s, which on the one hand, brings the vigorous development to financial industry, on the other hand, attracts the new financial crisis. Especially when it comes into the 1990s, the Asian financial crisis makes people recognize that the governments intervene cannot stop the crisis immediately and entirely avoid the loss from crisis. Even if there is no massive financial crisis, the governments aiming at someone financial institution to adopt rescue measures cannot prevent it from the bankrupt as well. At the meanwhile, after the broken of financial crisis, the international power is combination. Hence, the governments should nip in the bud and regulate the financial institutions, keeping the stable of the whole financial system. This kind of supervision focuses on how to measure and manage the venture of operation rather than whether the task and risk level meet the standards or not. It emphasizes the space for

innovation and freedom for financial institutions and brings the supervisors more and more flexibility.

Here are some measures on supervision financial industry.

- Releasing the regulation and strengthening the supervision of financial industry at the same time;
- Reforming the federal deposit insurance system;
- Canceling financial separated operation system;
- Canceling the limitation of bank business area;
- Canceling the separated system between bank industry and business industry.

It is a kind of rational period of financial regulation in the USA to some degree. It reforms supervision thoughts, basis and methods. The features of it are encouraging the competitions among financial institutions and considering the financial system efficiency, at the meanwhile, strengthening the regulation of financial industry so as to chase for the combination of competition and stabilization, security and efficiency as much as possible.

4.1.8 The supervision after financial crisis (2009-Now)

On June 17th 2009, the president Obama declares a reform project named *Financial Regulatory Reform-A New Foundation: Rebuilding Financial Supervision and Regulation*. The reform project mainly includes following contents:

- The regulation concept of rebuilding the government as the core. In the period of Greenspan, there existing a kind of concept which aiming at industry self-regulation and enterprise internal control. The core supervision function of government is going to be weakened and the right of management moves from the shareholders to the managers. In this crisis, the Wall Street managers take risks in order to chase for higher payments leading the risk cannot be controlled. With the company shares deeper separated, the concept of relying on the industry self-regulation and enterprise internal control is to be proved fail. The project emphasizes on the importance of financial institutions to market operation, which should be strongly supervised and managed. In addition, the core

position of government is not only shows on the risk preventing, but also the process of risk managing;

- Adjusting the supervision frame. The lacking position of financial market supervision is the powderhose. The project clearly shows, firstly, from the point of financial market, the supervision is not only in internal market, but also the over the counter; secondly, from the point of financial institution, taking the hedge funds into supervision; thirdly, from the point of financial products and services, all the financial derivative products trades should be recorded and regularly reported. And the standard financial derivative product trade should be completed in the supervised places;
- Strengthening the right of FED and capability of supervision coordination. The project declares to set up a *FSOC (the Financial Services Oversight Council)* to prevent the rights of FED more powerful and develop the coordination of supervision authorities. What is more, this council has the right to gain the necessary information from any financial institutions and request the reaction to other supervision authorities based on its behaviors;
- Developing protection system of investors and consumers. The USA government protects the interests of investors and consumers in the area of credit cards and estate after the crisis. In order to protect and develop the system, the project rises to set up a financial protection institution which owns the rights to rule standards and the right to punish, *CFFPA (Consumer Financial Protection Agency Act)*. It aims at providing the equal trade position in financial activities and fair trade right.

The project of Obama is more practical but still opposed by bank industry. From the realistic operation point, it is a large cost of reintegrating supervision authorities and the pressure of processing the reform itself is hard as well. Under prevent of special interest groups and plenty of politics factors, the financial supervision laws become an unsure arena chasing for interest.

Figure 4.1 Main Legislation on Financial Supervision in the USA

National Bank Acts

- **Date issued:** 1863
- **Issuing authority:** United States Congress

Banking Act of 1933(Glass-Steagall Act)

- **Date issued:** 1933
- **Issuing authority:** United States Congress

Securities Exchange Act

- **Date issued:** 1934
- **Issuing authority:** United States Congress

Bank Holding Company Act in 1956

- **Date issued:** 05-09-1956
- **Issuing authority:** 84th United States Congress

Federal Deposit Insurance Corporation Improvement Act of 1991

- **Date issued:** 12-19-1991
- **Issuing authority:** 102nd United States Congress

Foreign Bank Supervision Enhancement Act(Truth in Savings Act)

- **Date issued:** 12-09-1991
- **Issuing authority:** 102nd United States Congress

Financial Modernization Act (Gramm-Leach-Bliley Act, GLBA)

- **Date issued:** 11-12-1999
- **Issuing authority:** 106th United States Congress

Dodd-Frank Act

- **Date issued:** 07-15-2010
- **Issuing authority:** 111th United States Congress

Source: Source: The Group of Thirty, *The structure of Financial Supervision Approaches and Challenges in a Global Marketplace*, 2008, 123 pages, ISBN 1-56708-142-8

4.2 Present supervision institutions

The USA owns the most completed regulation system in the world. As the financial leader of the world, the financial regulation system is developing through one more century and finally forming the method of double and many layers regulation.

4.2.1 Supervision authorities of the bank industry

The United State sets supervision authority into two levels, federal and state government. The state government has five main supervision institutions, OCC, FED, FDIC, OTS and NCUA.

- FED, the Federal Reserve System set by *the Federal Reserve Act of 1993*. The main aim is to make monetary policy, supervise banks and financial holding companies, keep the financial stable and run the function of financial services;
- OCC, the Office of Computer of the Currency, which is under the jurisdiction of Treasury Department of United States, set by *the National Currency Act of 1863*. Its main function is to give out the license of national banks and supervise;
- FDIC, the Federal Deposit Insurance Corporation, set in 1933, which aims at preserving the stable of financial system and public belief by protecting the deposit from bank and deposit institutions and supervising the insured institution;
- OTS, the Office of Thrift Supervision, is charging for the supervising of deposit associations and holding companies;
- NCUA, the National Credit Union Administration, the main aim is to give out the license of federal credit union and supervise. What's more, protecting the deposit of the whole federal credit union and almost state credit union.

In addition, the *FFIEC (Federal Financial Institutions Examination Council)* , as the coordinated institution from the above-mentioned 5 supervision authorities, is mainly in charge of making unified regulation principle and report forms.

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graph TD; PWG[PWG] --- FRB[FRB]; PWG --- OCC[OCC]; PWG --- OTS[OTS]; PWG --- FDI[FDI]; PWG --- SB[State Banking];
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The diagram illustrates the organizational structure of the Prudential Regulatory Group (PWG). At the top is the PWG box. Below it, a horizontal line connects to four boxes: FRB, OCC, OTS, and FDI, representing the Federal level. Below these, another horizontal line connects to a single box labeled State Banking, representing the State level.

FRB: Federal Reserve Board

4.2.2 Supervision authorities of the security industry

- The Ministry of Treasury

- SEC (Security and Exchange Commission)

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execution of a series of legislation, so as to protect the rights of security issuers, investors and traders. Preventing adventure and speculation and keeping a stable price level.

- CFTC(Commodity Futures Trading Commission)

It is set in 1974, in charge of supervising the futures and options in the USA.

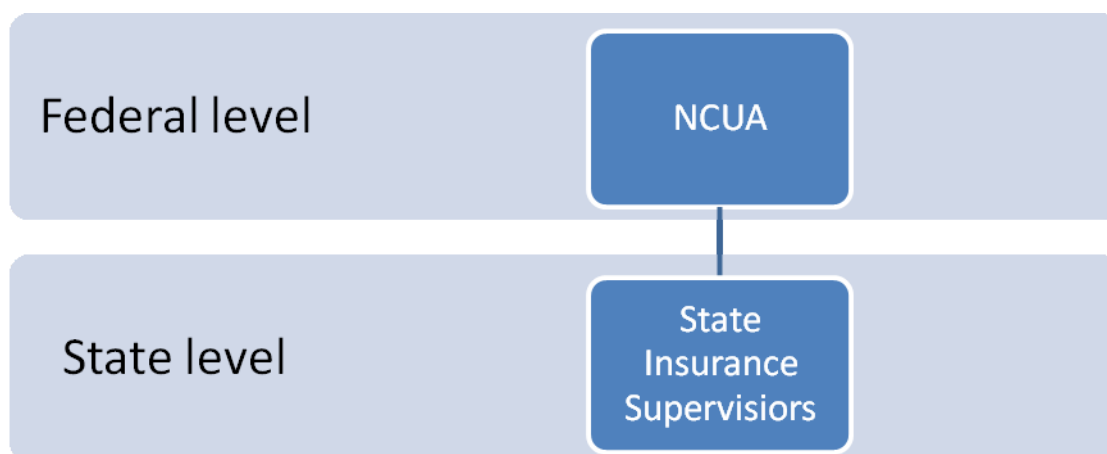
- MSRB (The Municipal Security Rule Board)

The United States Congress sets the *Municipal Security Rule Board in 1975*, allowing it publishing the related supervision duty. MSRB is a self-regulation organization, supervised by *SEC (Security and Exchange Commission)*.

- NASD(National Association of Securities Dealers)

It is a security industry self-regulation organization, which charges the operation and regulation of *NASDAQ* and *OTC*. In 2007, NASD and NYSE merges and setting the *FINRA (The Financial Industry Regulation Authority)* who is in charge of supervising the broker's agency, trade agency and investors.

Figure 4.3 Supervision Authorities of Insurance Industry in the USA



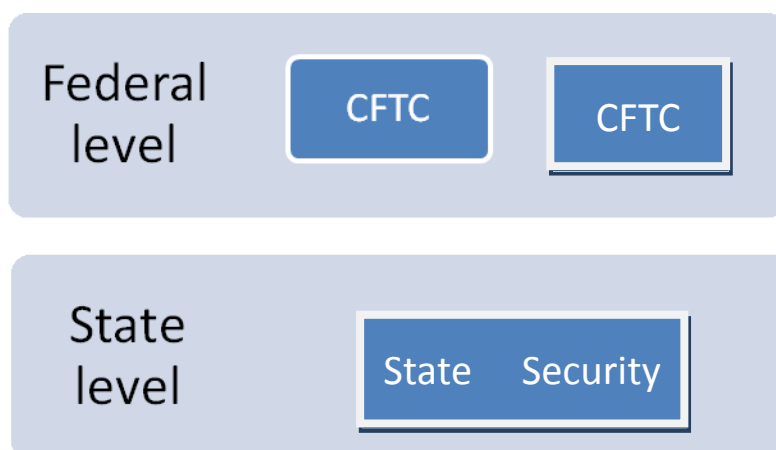
Source: The Group of Thirty, *The structure of Financial Supervision Approaches and Challenges in a Global Marketplace*, 2008, 123 pages, ISBN 1-56708-142-8

4.2.3 Supervision authorities of the insurance industry

The duty of insurance industry supervision in the USA is in charge of market permission and daily regulation by each state insurance supervision authorities.

What's more, each state insurance authorities set up the NAIC (the National Association of Insurance Commission), as the auxiliary regulation institution of state insurance supervision authorities.

Figure 4.4 Supervision Authorities of Security Industry in the USA



Source: The Group of Thirty, *The structure of Financial Supervision Approaches and Challenges in a Global Marketplace*, 2008, 123 pages, ISBN 1-56708-142-8

4.3 Existing problems in financial crisis

There are more and more problems rising after the broking of financial crisis. As we all know, there are some leaks in financial regulation system and the innovation of financial regulation falls behind the economy development as well. What is more, the rating agency is also lacking the supervision which leads to information unpublicized.³⁰

³⁰Source:http://wenku.baidu.com/link?url=yKWI_LDrQVSUHz4jtBqhYmhNo2buLxCnwc8TxAVD6ywpPMBgyy2Fok_6DT9KZFERShmH5meWWkZ2j37IDURn08366asIF6IyuXmtxO_Uo0i

4.3.1 The repeat and blank in financial regulation system

The financial regulation system supports the boom of the USA in history, however, with the globalization and integration of financial institutions the acceleration of innovation in financial market, the appearance of crossing sale and the spread of adventure, the problems of the financial system in the USA are also more and more explored. Especially in this financial crisis, the financial regulation system cannot control the whole situation. Although the federal government arise the concept of function regulation, the financial supervision authorities in the USA cannot adjust the supervision structure in time.

In this way, not only will it bring the supervision arbitrage, but also lead the existing of overlapping and blank at the same time in supervision. And the reactions from regulation to market are too slow and lag.

4.3.2 The lag of financial innovation

The financial storm is the extent of crisis; however, the financial crisis is related to the financial derivative product in the financial innovation. Nowadays, the separated supervision structure is not only adjusting to the development trends of financial market, but also does not clearly authorize to the new change and development. It makes the advantages in separated supervision into the disadvantage, the exploring of repeat and blank regulation at the meanwhile.

4.3.3 The short of rating agency supervision

After the Great Depression³¹ (1929-39) (the deepest and longest-lasting economic downturn in the history of the Western industrialized world), the credit rating becomes the standard method of bonds investment of the USA. Investors regard the credit rating as the standard of what they can take. Owing to the sub-prime productions belongs to the complicated financing products, the investors cannot predict the internal value and venture correctly. So the credit rating is the only foundation to make investment decision. There is no

³¹ Source: <http://www.history.com/topics/great-depression>

doubt that, the financial supervision authorities in the USA could not supervise the credit rating agencies which should take much more responsibility.

4.3.4 The short of public information

With the development of finance globalization, various financial productions have chances in trading business though all over the world. Under this large trading environment, the investors from all over the world have difficulty in controlling the information. However, it does not mean the information can be hidden or reported by error. Only by keeping public information published and highly transparent, can it avoid the information asymmetry between financial institutions and investors which is fair to the investors. And the financial institutions can operation and decrease the credit adventure. However, the financial institutions in the USA are expecting securitization to separate the risk within the whole world. The end of this kind of irresponsible method is just strengthening the conflict of information asymmetry among the traders, increasing the credit venture, if the debtors and investors do not know what potential ventures they are facing. Once the situation changes, the debtors cannot repay liabilities, the houses will be sold and the liabilities institutions are set in risk. In addition, the investors cannot withdraw the principal. After the financial crisis, there are many supervision institutions starting searching related financial institutions hidden the problems stimulating the merge security information.

4.4 The important financial regulation reform after crisis

Owing to the initiating from the sub-prime crisis to the global financial crisis, the impact has lashed to each country in the world, leading the world setting in the most serious depression after the Second War. Although there are many reasons in causing this global economic financial crisis, the loser of regulation to finance, the loser of management from liabilities securitization, the speculation with high risk of financial institutions, should take all these responsibilities.

4.4.1 The proposing of Dodd-Frank Act

Dodd-Frank Wall Street Reform and Consumer Protection Act which is also called *Dodd-Frank Act*. It is regarded as the most well-informed and significant financial supervision reform from 1930s. This act aims at promoting the stable finance, protecting the interest of taxpayers and consumers by developing the accountability system and transparency of financial system.

The largest reform is so called the *Volcker Rule*, which limits the investment banks self-operation trade among hedge funds and private equity. However, it still cannot be concluded if there is any basically influences on profit models of investment banks or not. Comparing to the *Glass-Steagall Act*³²(also known as the Banking Act of 1933), it is much loser. In addition, there is no doubt that the leverage ratio will go down in investment banks and the risk will be prevented. There won't exist derivate products like high leverage and lacking supervision any more.

- Strengthening the regulation of financial institution. The reform states that all the financial institutions bringing serious risk to financial system should be supervised strictly;
- Building the whole position supervision to financial market;
- Protecting consumers and investors from financial behaviors. The reform states that in order to rebuild the confidence of financial market, it is necessary to strictly supervise the financial service and investment market. Government must promote it more convenient, fair, and responsible and open.
- Giving government more necessary policy instrument to face financial crisis in order to avoid the conflicts between rescuing enterprise and making it bankrupt.
- Building international supervision standard and promoting international cooperation. Therefore, reform act suggests reforming the frame of enterprise capital, strengthening the supervision to international financial market, supervising the cooperation between

³² Source: http://useconomy.about.com/od/glossary/g/Glass_Steagall_Act.htm

domestic and foreign enterprises and strengthening the ability of facing international crisis.³³

4.4.2 The main content and new characteristics

The whole principle of financial regulation reform is to strengthen supervision. The core concept mainly shows in two aspects, firstly, changing the present super financial institutions, promoting the preventing of efficient systematic risk; secondly, protecting the disadvantaged groups, avoiding cheats in financial businesses.

- Promoting the rebuild of supervision authorities and supervision function, preventing systematic risk;
- Funding the CFPA (Consumer Financial Protection Agency), increasing the protection of consumers;
- Strengthening the supervision of system important institutions, solving the old problems;
- Regulating and standardizing the securitization and OTC derivative product markets;
- Fulfilling the blank supervision of hedge funds, private placements and credit rating agencies;
- Taking strict bank capital supervision and businesses supervision, controlling the potential operation venture.

What is more, the *Dodd-Frank Act* rules that the financial managers are supervised as well so as to avoid the over chasing to financial risk of senior executive.

4.4.3 The influence on international financial markets

This supervision reform is the largest reform since 1930s and as the core of international financial system; the position of the USA is more and more vital in international market. After publishing of the *Dodd-Frank Act*, the USA uses the influence in international financial

³³ Source: <http://gb.cri.cn/27824/2009/09/17/Zt4005s2624696.htm>

institutions to promote the international supervision standard at the same time. In a word, the financial regulation reform in the USA has a deep influence on international financial market.

- The standard of international financial market will get increased;
- The supervision scope of international financial market will be extended;
- The supervision cooperation in the international financial market;
- The market structure in the international financial market will change;
- The leadership in the international financial market will get influenced.

According to the plan of Obama, American government will strengthen regulation on the whole. However, it is from the aspect of government, from the aspect of enterprise, how can those large financial enterprises face this situation?

The risk from the financial reform is both two sides. First of all, pushing enterprise enlarge will lead larger system risk; secondly, it will increase unfair competition in financial market. What is more, the short of relevant financial supervision stuff is also bad to reform.

In addition, we should realize that we cannot rely all on the regulation. The operation of government is to alleviate the crisis and weaken the crisis.³⁴

As the most powerful country in the world, the results of financial reform in the USA are determined by various factors. It includes the party and politics factors, also the market reality. A real powerful country cannot lack the open and developing financial market.

4.5 Example analysis of financial institution

In this part, I will introduce an example of bankruptcy of Lehman Brothers.

4.5.1 General introduction

The Lehman Brothers is a global financial services firm. Before declaring bankruptcy in 2008, Lehman Brothers is the fourth largest investment bank in the USA, doing business in

³⁴ Source: <http://star.news.sohu.com/s2010/jrjg/>

investment banking, equity and fixed-income sales and trading, research, investment management, private equity, and private banking.³⁵

Influenced by the sub-prime crisis, the Lehman Brothers appears huge number loss and applies the bankruptcy protection on September 15th, in 2008.

As the largest bankrupt act in history of the USA, the astonishment arose by the Lehman Brothers impacts the financial system and entity economy of the USA and quake it into cliff.

4.5.2 The reason leading Lehman Brothers bankruptcy

The reason from the outsides includes the sub-prime crisis and the ignorance of government. First of all, before the break of sub-prime, Lehman Brothers owns a great number of bad credit financial products and mortgage. Therefore, after the break of sub-prime, the credit of financial products and the value of market sharply decrease.

Secondly, even though some banks show interest on acquisition to Lehman Brother, but the reason why leads them give up is not getting the promise from the American government.

The reason from the internal sides is from the mistake of decision; Lehman Brothers have more burdens of assets.³⁶

4.5.3 The leaks leading Lehman Brothers bankruptcy

There is existing some financial regulation leaks which leading Lehman Brothers who works on complicated derivative business escapes from the supervision. From the deep sights, lacking of coordinated and united financial regulation framework is the original reason of failure of financial regulation.³⁷

- The government lacks of a whole and united regulation to investment. In the model of independent investment bank, the SEC is the only one supervision authority in the USA and its main duty is related to security trade. Other supervision authorities less

³⁵ Source: <http://gb.cri.cn/27824/2009/09/17/Zt4005s2624696.htm>

³⁶ Source: <http://stock.hexun.com/2011-11-01/134769758.html>

³⁷ Source: <http://finance.sina.com.cn/money/bank/yhpl/20130924/072616830933.shtml>

participates in regulating. In the system, it is lacking in regulation to investment banks and risk investments.

- It is lacking in united and efficient supervision to non-traditional financial productions trade. Although the supervision authorities set supervision rules to commercial banks and insurance companies, the large risk hole to non-traditional regulation.
- The communication system among supervision institutions is not complete, lacking the foundation of united regulation. At the primary period of crisis, some risk phenomena has already arisen. However, the related supervision sectors cannot coordinate and take effective measures, losing the best time to handle crisis.

4.5.4 The influence of bankruptcy

We cannot deny that it is necessary when accidents happen, but it is still a bad plan which will cause subsidiary function. Therefore, it is important to cancel the gap among the financial regulation framework and strengthen the regulation to prevent the happen of financial crisis. Under the situation of more and more complicated financial markets, separated supervision method does not meet the demand of economic development to finance and it is also hard to take effective supervision to crossing-markets financial production and financial instruments. Therefore, to build a united and powerful financial system is the internal recommend and trends to financial development.

What is more, the bankruptcy of Lehman Brothers will promote the building of financial new order. Every country which suffers the crisis in the world are thinking the same problem. The world is need of building a system which is independent from the diversified currency financial system and fair open financial order, especially to the new market countries. What needs more consideration is to control the rhythm of financial innovation and financial open degree under the situation of undeveloped financial system and weak financial system. It includes how to sufficiently supervise the financial market and prevent financial risk, how to protect the financial leading right and own country interest and how to take international financial investment.

5 Comparison of the Selected Markets

Different financial regulation theory and goals lead to different regulation system. In fact, the financial regulation goals are similar in each financial supervision authorities in all over the world. The financial regulation goal is to keep financial market fair, justice and public. What is more, it is important to protect legal and reasonable interest of financial participants as well. Therefore, we should consider the financial regulation theory and national conditions, which is the main reason leading the difference between China and the USA.

5.1 Correspondences

China and the USA both own the institutions which plays the role like the issuing currency and regulating. It stands for the main position where FED and PBOC in. And owing to the same separated supervision system, China and the USA are both suffering the duplication supervision and vacuum supervision.³⁸

5.1.1 Taking separated supervision

Because of the different economy, society, political form and credit development, the regulation system is diversified in different countries. In addition, the financial operation methods and supervision methods are not the same. The country which takes separated business can take the unified supervision; the country which takes mixed operation methods also takes separated supervision. And as we already know, the supervision methods are including separated supervision and unified supervision.

However, China and the USA both adopt the *separated supervision* method, though the operation methods are different.

In other words, the supervision system still hold on separated regulation and it means the financial institutions are divided into three parts, banking, security and insurance by financial market. In each part, there is a specialized supervision authority that is in charge of the whole

³⁸ Source: <http://www.docin.com/p-328384341.html>

supervision. In the USA, many supervision authorities exist in different financial businesses and different levels governments.

The separated supervision method is not perfect, such as the bad coordination among each supervision institutions, which is easy to form the empty space. And the supervision authorities are of large shape, which will take high costs. What is more, when it comes to supervise the universal banks, the separated supervision is easier to raise the repeating supervision problems.

5.1.2 The main position of FED and PBOC

Before the financial crisis, the USA holds the theory of increasing the function of central bank. Not only leave the supervision function in FED, but also let the function of security and insurance centralized. Therefore, the function of FED includes issuing currency and supervising. Keeping the strong supervision is good for keeping the financial system stable, which is also a base of making correct monetary policy. This method does good to help the financial supervision keep away from the administration.

The PBOC is the central bank in China. With the development of financial market, various types of financial institutions are connected. Under the situation of separated supervision, in order to prevent the crisis breaking, it is necessary to build efficient system of sharing financial supervision information and coordination. PBOC is good at judging the macro economy, adjusting method, basic data and managing talents. And as the last debtor and risk holder, PBOC should play a role in leading and coordinating in system.

5.1.3 Duplication of supervision and vacuum supervision

Owing to the federal and state both have the financial supervision rights and many sectors are in charge of supervising, it leads the duplication of supervision. The regulation rules of banking industry, insurance industry, securities industry and future industry are duplication and confliction. And there also exists the vacuum supervision, which focuses on financial derivatives area.

In China, the supervision concepts and methods are relatively undeveloped. The government issues many supervision policies which makes the regulatory failure or excessive regulation.

5.2 Differences

The largest difference between China and the USA is the different supervision methods. China takes institutional regulation and the USA takes the functional regulation.

Figure 5.1 The Differences between the USA and China

Nation	The USA	China
Financial supervision system frame	Double levels and multi subjects	One bank and three supervision authorities
Supervision method	Market self-regulation	Administration method
Supervision subjects	Central bank and other government regulators	Central bank
Regulation range	Preventive regulation Prudential regulation	Prudential regulation
Supervision purpose	Functional regulation	Institutional regulation

Source: <http://cdmd.cnki.com.cn/Article/CDMD-80201-2002123948.html>

5.2.1 Financial supervision system frame

- For the USA, the federal supervision authority and state supervision authority both have the supervision function to financial institutions. Except the Ministry of Treasury, the USA has set up *OCC* in the federal level. At the same time, each state government

establishes the several supervision institutions to finish the regulation tasks together;

- For China, after the establishment of *Shanghai Stock Exchange*(SSE)³⁹ (was founded on Nov. 26th,1990 and in operation on Dec.19th the same year. It is a membership institution directly governed by the China Securities Regulatory Commission (CSRC). The SSE bases its development on the principle of "legislation, supervision, self-regulation and standardization" to create a transparent, open, safe and efficient marketplace. The SSE endeavors to realize a variety of functions: providing marketplace and facilities for the securities trading; formulating business rules; accepting and arranging listings; organizing and monitoring securities trading; regulating members and listed companies; managing and disseminating market information) and *Shenzhen Stock Exchange* (SZSE)⁴⁰ (established on 1st December, 1990, is a self-regulated legal entity under the supervision of China Securities Regulatory Commission (CSRC). It also organizes, supervises securities trading and performs duties prescribed by laws, regulations, rules and policies. Its main functions include providing the venue and facilities for securities trading, formulating operational rules, receiving listing applications and arranging securities listing, organizing and supervising securities trading, supervising members; regulating listed companies, managing and disseminating market information and other functions as approved by the CSRC) the multi levels capital market is gradual developing. Besides the state-owned commercial banks, other joint-stock commercial banks are set up and foreign capital banks begin to come into China. What is more, the non-bank financial institutions fast develop especially the insurance companies and insurance markets. At that time, the PBOC is the only super central bank which cannot manage financial affairs by its own. After that, with the development of security industry and insurance industry, China sets up the CBRC, CSRC and CIRC performing the one bank and three supervision authorities frame.⁴¹

³⁹ Source: <http://english.sse.com.cn/>

⁴⁰ Source: <http://www.szse.cn/main/en/>

⁴¹ Source: <http://www.studa.net/jinrong/090205/1554005-2.html>

5.3.2 Supervision methods

- For the USA, the financial supervision system has the superior to financial institution supervision. Under the double levels and multi subjects structure, the financial supervision arise the relationship of competition each other. To some degree, it is a kind of market regulation that anyone of the supervision institutions cannot influence the management which is good for increasing the supervision quality and efficiency;
- For China, the financial institutions are supervised by PBOC and other three authorities have rights to supervise. It is intervened by governments deeply.

5.3.3 Supervision subjects

- For the USA, the supervision subjects are federal level and state levels, each levels of supervision activities cooperates and supplies each other which is good for shortening the blind area in financial supervision, increasing the supervision efficiency and ensuring the financial system safe operation;
- For China, the supervision subject is only the PBOC, which depends on the central bank regulation. The disadvantage is that the dependence of industry self-regulation institution is low, which is always subsidiary to related sectors; the function cannot be performed as usual.

5.3.4 Regulation range

- *Prudential regulation* means supervising the banks by administration method. The purpose is to prevent the bank adventure so as to keep the banking industry safe, stable and efficient;
- *Preventive regulation* means that supervision authorities supervise the institution structure, operation subjects, business area, capital request and internal system by adopting the positive supervision strategy.

5.3.5 Supervision propose

- The financial supervision system in the USA more focuses on the leading function of financial market, the government less intervenes. the government reacts when the problems arises, which is easy to lead to regulation delay;
- For China, the freedom degree is low of financial market and influence by government, which is suit in undeveloped situation in China.

5.3 Recommendation

From the comparison and get acknowledged of the USA financial reform, we can learn from the USA to develop the financial regulation system.⁴²

First of all, supervision with purpose is a reform method to be chosen. The financial market in China is still in the position of growing; the characteristic of financial enterprise is obvious. It is not necessary to take unified supervision. Basically, no matter what kind of supervision institution system, the purpose of supervision is somewhat consistent. It means that to keep safe and stable finance industry, protect the public interest and operation order. Therefore, basing on the functional regulation, we can ensure the subject of supervision target who is in charge.

Secondly, control the whole market risk by ensuring the subject who is in charge and realize the stable supervision of market. On the situation of market unified, the first supervision target is to supervise the stable market and also is the main hinder of preventing the financial risk. The authority should establish the relevant rules and set up specialization authority.

Thirdly, take right recognition of supervision institution. Under the situation of separated business, each supervision institution may have conflicts leading the result of unfair competition among financial company. Hence, it is necessary to coordinate supervision policy.⁴³

⁴²Source:http://wenku.baidu.com/link?url=-q9b8zoRlenjyoTlpMOPcfbdkQeDWE3hK9hpvJwFVh9fZ5iQZ_duJgxHQQ7UML-Xlam9V9I--GKmX32Lr7cTFyitsEz17NPWyWjkYkSFbG_

⁴³ Source: <http://www.studa.net/jinrong/090205/1554005-2.html>

Last, it is also important to expand the supervision area by improving legislations.

5.3.1 Protecting investors' rights

At present, the system of protecting Chinese financial consumers is blank, the consumers' rights are not able to be protected. At the same time, with the deeper development of financial products, China has to learn from the USA, building the institution about protecting the consumers, developing financial supervision on products selling and customer service, promoting the financial institution self-regulation and protecting the interest of the consumers and investors.

5.3.2 Researching availability of united regulation

In supervision system, what we can learn from the United Kingdom and German is building the single financial supervision institution, adopting the united supervision. The aim of it is to control the financial supervision information as whole, know about financial market operation situation, and make the united regulation rules so as to protect from the system risk. Under the situation of healthy operation of financial steady, finance will be better to service for the economy development.

5.3.3 Considering the protection of system risk

System risk is a great threat to financial market. The USA has set up the institution to keep the financial stable, giving the rights of supervising the system risk. What is more, it ensures the venture evaluation and management method so as to prevent the system risk. Therefore, China should realize the importance of system risk, it exists in every corner in banking, security and insurance. If there is some one part arising the problem, it will quickly spread around and lead to the whole breakdown in financial system. Hence, the direction of China financial supervision reform in future should perform the connection of system risk requisition.

5.3.4 Expanding the supervision scope

- Building financial derivatives information announcement system;
- Commercial banks should publish the scientific derivatives risk management frame to strengthen the investigation of credit among traders. And promoting the commercial banks to build the reasonable pricing system;
- Setting up the united financial derivatives markets trade system, unify the behaviors of derivative market participants and make the characteristic management system and act of different nature derivatives;
- Strengthening the cooperation among supervision authorities, building the coordination system among the supervision sectors.

At the same time, China should strengthen the international cooperation in the situation of economy and financial globalization. Only in this way, can we better use the relative function of financial derivatives products, prevent the system risk and create a good environment for entity economy.

5.3.5 Developing the credit industry

A good operation of credit industry can increase the supervision effect so as to promote the financial industry stable development. Hence, China should pay attention to the system rules and market model frame about the credit industry. On the one hand, issuing the rules about credit as soon as possible, on the other hand, thinking highly of credit rating market development, raising the credit industry level.

6 Conclusion

In recent years, China financial service industry and financial market are open more and more widely and deeply. The whole financial industry has a refresh performance. But we still should focus on the procedure to build the Chinese style financial supervision system. Banking industry, security industry and insurance industry should research positively the coordination system and supervision system. Trying to suit the trends of international financial market; breaking the single service method and providing a basket business service. Promoting the development of legislations in financial operation and offering the law protection after participant in WTO. Trying to coordinate in sector of bank, security and insurance and developing the healthy and united financial market.

From the content of this thesis, we have achieved the aim of stating the financial regulation situation in China and the USA and getting the recommendation from the comparison of these two countries.

In this thesis, we can learn the basic knowledge from the definition, purpose, content, principles of financial regulation and the two main fundamental methods of financial supervision. After, we can draw some conclusions from China by knowing the history and present development of financial regulation. The example of bankruptcy of Hainan Development Bank shows that even in an undeveloped financial market, it is important to supervise the economy operation as well. What is more, as the leader of world economy, the USA has been through a long term progress in supervising financial market. However, there still existing some factors which can lead to the financial problems. The bankruptcy of Lehman Brothers is a result of less regulation. Through the comparing between these two countries, we can conclude more supervision ways and management methods. We must supervise the financial subjects by improving the financial supervision system and reform the supervision method.

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List of Abbreviations

BOC: Bank of China same line
CBRC: China Banking Regulatory Commission
CCB: China Construction Bank Corporation
CFPA: Consumer Financial Protection Agency Act
CFTC: Commodity Futures Trading Commission
CIRC: China Insurance Regulatory Commission
CSRC: China Securities Regulatory Commission
FDIC: Federal Deposit Insurance Corporation
FED: Federal Reserve System
FFIEC: Federal Financial Institutions Examination Council
FINRA: Financial Industry Regulatory Authority
FRB: Federal Reserve Board
FSOC: Financial Services Oversight Council
ICBC: Industrial and Commercial Bank of China
MSRB: The Municipal Security Rule Board
NASD: National Association of Securities Dealers
NASDAQ: National Association of Securities Dealers Automates Quotation
NCUA: National Credit Union Administration
OCC: Office of Computer of the Currency
OTS: Office of Thrift Supervision
PBOC: People's Bank of China
PICC: People's Insurance Company of China China Holdings Company
PWG: President Working Group on Financial Market
SAFE: State Administration of Foreign Exchange
SEC: Securities and Exchange Commission
SSE: Shanghai Stock Exchange
SZSE: Shenzhen Stock Exchange

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Ostrava dated May 3rd 2019

Junxian Jiang
Student's name and surname

List of Annexes

Annex 1 The Content of Dodd-Frank Act

Annex 2 The Type of Regulation

Annex 1

The Content of Dodd-Frank Act

Provisions for	Senate version	How House bill differs
Consumers	<ul style="list-style-type: none"> Consolidates responsibilities from seven agencies into a Bureau of Consumer Financial Protection within the Federal Reserve system to oversee products made available to consumers. Limits ability of mortgage lenders to assess penalties on borrowers who pay off the loan early. Prohibits paying brokers and loan officers more to steer borrowers to higher interest rates or certain risky features; commissions would be based on the size or number of loans originated. 	<ul style="list-style-type: none"> Creates an independent Consumer Financial Protection Agency. Auto dealers are exempted from its scrutiny.
Investors	<ul style="list-style-type: none"> Creates Investment Advisory Committee within Securities and Exchange Commission. Creates Office of Investor Advocate within SEC to identify problems in dealing with SEC and provide assistance. Gives SEC the authority to grant shareholders proxy access to nominate directors. Requires directors to win by majority vote in uncontested elections. Gives shareholders the right to nonbinding vote on executive pay, excluding golden parachutes. 	<ul style="list-style-type: none"> Would require institutions with assets of at least \$1 billion to disclose to regulators the structures of all incentive-based compensation.
Banks	<ul style="list-style-type: none"> Preserves the Fed's and FDIC's bank-supervision roles; calls for OTS to be absorbed by the OCC. Federal Reserve Board would keep oversight of largest bank holding companies. State banks and holding companies would either be regulated by the Fed or FDIC. Banks would be generally barred from using their own capital to engage in speculative trades. 	<ul style="list-style-type: none"> Regulators would have the power to stop banks on a case-by-case basis from risky activities.
Hedge Funds	<ul style="list-style-type: none"> Requires investment advisers of hedge funds with \$100 million or more in assets to register with the SEC. 	<ul style="list-style-type: none"> Applies to funds with assets of \$150 million or more; exempts venture-capital funds.
Derivatives	<ul style="list-style-type: none"> Requires that many derivatives and over-the-counter financial products be traded on regulated platforms. 	<ul style="list-style-type: none"> Exempts many end users from mandatory central clearing.
Securitizations	<ul style="list-style-type: none"> Requires companies that package loans into marketable securities to hold at least 5% of the credit risk 	<ul style="list-style-type: none"> Exempts education, agriculture, veterans and small-business loans.
Insurers	<ul style="list-style-type: none"> Requires issuers to disclose more information about and analyze the quality of underlying assets. Creates Office of National Insurance within Treasury to monitor industry, recommending to the systemic-risk council insurers that should be treated as systemically important. Office would recommend ways to modernize insurance regulation, but it is explicitly not a new regulator. 	<ul style="list-style-type: none"> Proposes creation of a Federal Insurance Office with similar characteristics.
Credit Rating Agencies	<ul style="list-style-type: none"> Creates office at SEC to administer credit rating agencies' rules and practices. 	<ul style="list-style-type: none"> Also creates seven-member advisory board for credit raters.
Other Elements	<ul style="list-style-type: none"> Creates Financial Stability Oversight Council, led by Treasury secretary, with nine voting members. Agency would identify systemic risks to the economy, promote market discipline and respond to emerging risks. It would also write regulations for risk-based capital, leverage and liquidity requirements. Establishes a Financial Research Fund that imposes fees on nonbank financial companies and bank holding companies with more than \$50 billion in assets. 	<ul style="list-style-type: none"> Also creates council led by Treasury secretary, but with 10 voting members. The Federal Reserve is required to impose a fee on large firms, which would pay into a \$150 billion fund to manage the dissolution of failing firms considered systemically significant.

Source: <http://www.ritholtz.com/blog/2010/06/comparing-financial-regulatory-reform-bills/>

Annex 2

The Type of Regulation

Type of regulation	Objectives	Examples of key policy instruments
Macroeconomic	To maintain control over aggregate economic activity; maintain external and internal balance	Reserve requirements, direct credit and deposit ceilings, interest rate controls, restrictions on foreign capital
Allocative	To influence the allocation of financial resources in favor of priority activities	Selective credit allocation, compulsory investment requirements, preferential interest rates
Structural	To control the possible abuse of monopoly power by dominant firms	Entry and merger controls, geographic and functional restrictions
Prudential	To preserve the safety and soundness of individual financial institutions and sustain public confidence in systemic stability	Authorization criteria, minimum capital requirements, limits on the concentration of risks, reporting requirements
Organizational	To ensure smooth functioning and integrity of financial markets and information exchanges	Disclosure of market information, minimum technical standards, rule of market-making and participation
Protective	To provide protection to users of financial services, especially consumers and non-professional investors	Information disclosure to consumers, compensation funds, ombudsmen to investigate and resolve disputes

Sources: Adapted from Vittas (1992, p. 63)

Source: <http://www.emeraldinsight.com/journals.htm?articleid=847769>